

Message Text

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ACTION NEA-16

INFO OCT-01 ISO-00 SS-20 EB-11 SP-03 DRC-01 RSC-01 INR-11

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P 190951Z JUL 74

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC PRIORITY 3196

C O N F I D E N T I A L SECTION 1 OF 2 TEL AVIV 4056

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E.O. 11652: GDS

TAGS: OVIP (SIMON, WILLIAM E), EAID, IS

SUBJ: SIMON VISIT: MEETING WITH FINANCE

MINISTER RABINOWITZ

1. FOLLOWING IS UNCLEARED REPORT OF CONVERSATION AND
IS SUBJECT TO CHANGE AFTER REVIEW BY SIMON PARTY.

2. SUMMARY. SECRETARY SIMON AND HIS AIDES MET WITH
FINANCE MINISTER YEHOASHUA RABINOWITZ AND SENIOR
STAFF OF THE MINISTRY OF FINANCE, JULY 17. DURING THIS
SESSION RABINOWITZ IDENTIFIED MAJOR ECONOMIC PROBLEMS AND
HIS STAFF PRESENTED PROPOSALS FOR USG ASSISTANCE IN SOLVING
THEM. AMONG THE SUBJECTS ADDRESSED WERE OUTLINE OF BALANCE
OF PAYMENTS DIFFICULTIES, PROPOSALS FOR STIMULATING
AMERICAN INVESTMENT IN ISRAEL, THE JOINT US-ISRAEL DESALIN-
ATION PROGRAM, A PROPOSED TREATY ON AVOIDANCE OF DOUBLE
TAXATION, AND US-ISRAEL BINATION SCIENCE FOUNDATION.
FOLLOWING REPRESENTS SUMMARY OF PAPERS PRESENTED BY GOI AND ORAL
COMMENTS DURING MEETING. END SUMMARY.

3. AFTER GREETINGS RABINOWITZ LED OFF WITH FORMAL
PRESENTATION OF ISRAEL'S PROBLEMS. HE SAID 3 MAIN
FACTORS INFLUENCE ISRAEL'S POLICIES IN ECONOMIC
SPHERE.

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(A) IN 26 YEARS ISRAEL HAS NEVER ENJOYED REAL PEACE.

IN CONSEQUENCE ISRAEL HAS ALWAYS HAD TO SPEND
LARGE PROPORTION OF ITS NATIONAL INCOME FOR DEFENSE.
ONLY IF ISRAEL IS STRONG CAN
IT DETER WAR AND CONTRIBUTE TO PEACE PROCESS.

(B) ISRAEL'S PRIMARY TASK AND NATIONAL DUTY IS TO
SERVE AS HOMELAND OF JEWISH PEOPLE. DURING 26 YEARS
ISRAEL HAS ABOSRBED OVER 1.5 MILLION IMMIGRANTS, MOST
OF WHOM WERE PENNILESS WHEN THEY ARRIVED.

(C) RAPID DEVELOPMENT OF ISRAEL'S ECONOMY IS INDIS-
PENSABLE, AND THIS DEPENDS UPON GUARANTEEING CONSTANT
FLOW OF INVESTMENTS FROM ABROAD.

4. RABINOWITZ CONTINUED: TWO MOST CRUCIAL PROBLEMS
FACING ISRAELI ECONOMY TODAY ARE DEFICIT IN BALANCE OF
PAYMENTS AND INFLATION. BOTH, HE SAID, ARE LARGELY
PRODUCT OF OCTOBER 1973 WAR. BECAUSE OF WAR, DEFENSE
EXPENDITURES IN 1973 AMOUNTED TO 47 PERCENT OF GNP,
AND WILL AMOUNT TO ABOUT ONE-THIRD THIS YEAR. MORE
THAN 22 PERCENT OF LABOR FORCE IS EMPLOYED IN DEFENSE
AND RELATED OCCUPATIONS. DEFENSE IMPORTS DURING
1972 WERE ONLY \$700 MILLION, WHILE IN 1974 THEY WILL
BE \$2 BILLION. IN NEXT 3 YEARS DEFENSE IMPORTS (DIRECT
AND INDIRECT) WILL TOTAL \$8 BILLION. THIS WAS BASIS
FOR ISRAEL'S REQUEST FOR MILITARY AID OF \$1.5 BILLION
PER YEAR OVER NEXT "FEW" YEARS.

5. TO MEET DEMANDS ON ITS RESOURCES ISRAEL HAS INTRO-
DUCED DRASTIC ECONOMIC MEASURES SINCE 1973; THESE
INCLUDE NEW TAXES, COMPULSORY AND VOLUNTARY WAR LOANS,
REDUCTION IN SUBSIDIES ON ESSENTIAL FOOD COMMODITIES,
AND INCREASES IN FUEL AND ELECTRICITY PRICES. AS
RESULT TAX BURDEN HAS RISEN BY 40 PERCENT AS COMPARED
TO PREWAR LEVEL. RATION OF TAXES TO NATIONAL INCOME IS
NOW 63 PERCENT, HIGHEST IN THE WORLD. DECISIONS TO
DO THIS WERE DIFFICULT. AS A CONSEQUENCE REAL PRIVATE
DISPOSABLE INCOME HAS DROPPED; AND ISRAEL HOPES TO
PREVENT ANY RISE IN PRIVATE, AND FOR THAT MATTER PUBLIC,
CONSUMPTION DURING NEXT 4 TO 5 YEARS.
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6. ISRAEL WILL REQUIRE ANNUAL CAPITAL INFLOW OF
\$4 TO 4.5 BILLION IN EACH OF NEXT 4 OR 5 YEARS IN
ORDER TO MAINTAIN BOTH ISRAEL'S DEFENSE CAPABILITY
AND PACE OF DEVELOPMENT. SUCH LARGE CAPITAL REQUIRE-
MENTS DEPEND UPON GETTING MASSIVE FOREIGN AID. ISRAEL HAS
ALWAYS PUT AID TO GOOD USE, AND HE IS CONFIDENT
THAT WITH THIS KIND OF HELP ISRAEL WILL BE ABLE

TO REDUCE THE RELATIVE BURDEN OF DEFENSE EXPENDITURES
IN GNP.

7. SECRETARY SIMON REPLIED THAT HIS VISIT WAS AN
EARNEST OF GOOD FAITH THAT USG INTENDED TO IMPLEMENT
JOINT STATEMENT OF JUNE 17 EXPEDITIOUSLY. HE NOTED THAT PROPOSAL
TO FREEZE CONSUMPTION WAS AMBITIOUS,
AND WONDERED WHETHER IT WOULD BE ACCOMPLISHED THROUGH FISCAL
MEANS. AGMON (DIRECTOR GENERAL, MINISTRY OF FINANCE) NOTED
THAT THIS REFERRED TO A FREEZE IN GROWTH OF PER CAPITA CONSUMP-
TION; 1974 WOULD BE FIRST YEAR FOR SOME YEARS IN WHICH THIS
HAD BEEN DONE. HE NOTED BURDEN OF NEW TAXES RECENTLY
IMPOSED, AND EXPRESSED CONCERN THAT ISRAEL MIGHT BE
"OVER-SHOOTING." HE ALSO POINTED TO IL 2 BILLION IN
CUT FROM GOI BUDGET. SINCE LARGE PORTION OF BUDGET
REPRESENTING SALARIES COULD NOT BE TOUCHED, OTHER ITEMS
HAD TO BEAR MORE SERIOUS BURDEN TO ACHIEVE DESIRED OVERALL
15 PERCENT CUT. GAFNY (DIRECTOR, BUDGETS DEPARTMENT)
ADDED THAT DRASTIC CUTS IN LAST FEW WEEKS FELL PARTICULARLY
UPON PUBLIC CONSTRUCTION, WHICH WAS DEFERRED
FOR AT LEAST 6 MONTHS, EXCEPT HOUSING FOR IMMIGRANTS
AND SOCIAL CASES. DEMAND IN CONSTRUCTION SECTOR HAD
BEEN CUT BY IL 1.5 TO 2.0 BILLION, WHICH HE THOUGHT
WOULD ABOUT EQUALIZE DEMAND AND SUPPLY OF FACTORS
OF PRODUCTION IN CONSTRUCTION SECTOR. THEY HOPED THIS MEASURE
WOULD NOT HURT ECONOMIC GROWTH. SECRETARY SIMON SAID HE
APPLAUDED THESE DIFFICULT MEASURES, AND EXPRESSED
HOPE THAT THEY COULD BE SUSTAINED POLITICALLY.

8. SECRETARY SIMON NOTED THAT INFLATION WAS SERIOUS
PROBLEM IN BOTH OUR COUNTRIES, AND EXPRESSED VIEW
THAT PUBLIC WAS READY TO SUPPORT MEASURES REQUIRED
TO CURTAIL IT. INFLATION LEVELS IN BOTH COUNTRIES
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WERE FRIGHTENING PUBLIC. EVEN IF WE COULD
REDUCE INFLATION IN ISRAEL TO 15 PERCENT PER YEAR
AND IN UNITED STATES TO 7 PERCENT, THIS WOULD STILL
BE "PRETTY AWFUL."

9. NEUDORFER (DIRECTOR OF STATE REVENUE) NOTED THAT
RECENT TAX INCREASES MADE ISRAEL HEAVIEST
TAXED COUNTRY IN THE WORLD. HE HOPED TO INTRODUCE
VALUE ADDED TAX ON APRIL 1, 1975, SIMULTANEOUSLY RE-
DUCING OR ABOLISHING SOME OF OTHER INDIRECT TAXES.
AGMON COMMENTED THAT DIRECT TAXES WERE PROBABLY TOO
HIGH; HE HOPED TO INTRODUCE VAT AS SOON AS POSSIBLE.
IF POLITICAL SITUATION PERMITS THEY WILL REDUCE
DIRECT TAXES ALSO DURING NEXT 6 TO 9 MONTHS. IN RESPONSE
TO INQUIRY BY SECRETARY(PROMPTED BY AMBASSADOR), NEUDORFER

ADMITTED THAT EXEMPTION FROM TAX OF COST-OF-LIVING ALLOWANCES,
AND LOWER TAX RATES FOR OVERTIME AND PRODUCTIVITY PREMIA MADE
OVERALL TAX BURDEN MUCH LOWER.

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ACTION NEA-16

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TO SECSTATE WASHDC PRIORITY 3197

C O N F I D E N T I A L SECTION 2 OF 2 TEL AVIV 4056

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10. AFTER FOREGOING DISCUSSION OF GENERAL ECONOMIC
SITUATION WHICH INCLUDED QUESTION AND ANSWER SESSION,
FINANCE MINISTER RABINOWITZ SAID ISRAEL WISHED AND
URGED THAT UNITED STATES ASSIST IT TO BEAR HEAVY
DEFENSE BURDEN, COVER GAP IN BALANCE OF PAYMENTS,
MAINTAIN ADEQUATE LEVEL OF FOREIGN CURRENCY RESERVES, AND
CONTINUE VIGOROUS RATE OF DEVELOPMENT IMMIGRANT
ABSORPTION. ISRAEL LOOKED FORWARD TO RECEIVING SUB-
STANTIAL FINANCIAL AID. DETAILED JUSTIFICATION OF FINANCIAL
REQUESTS WOULD CONTINUE TO BE SUBMITTED ANNUALLY.

11. SPECIFICALLY, ISRAEL WOULD APPRECIATE FOLLOWING
STEPS:

(A) MEASURES TO PERSUADE AMERICAN FINANCIAL AND
BUSINESS COMMUNITIES TO INVEST IN ISRAEL;

(B) FINANCIAL ASSISTANCE TO AMERICAN INVESTORS IN
ISRAEL;

(C) ENCOURAGEMENT OF PURCHASE OF ISRAEL COMMO-
DITIES IN UNITED STATES; AND

(D) APPROPRIATE MEASURES TO ENSURE CONTINUING SUPPLY
OF RAW MATERIALS AND OIL TO ISRAEL.

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TO TRANSLATE THESE PROPOSAL INTO CONCRETE ACTION,
RABINOWITZ PROPOSED ESTABLISHMENT OF JOINT COMMITTEE
AT CAINET LEVEL, WHICH WOULD DEAL WITH FULL RANGE OF
ECONOMIC MEASURES. UNDER THIS COMMITTEE ISRAEL PROPOSED
ESTABLISHMENT OF 4 PROFESSIONAL COMMITTEES, DEALING
RESPECTIVELY WITH INVESTMENT, RAW MATERIALS, GENERAL
KNOW-HOW TRANSFER, AND PROMOTION OF TRADE. SECRETARY
SIMON AGREED TO RABINOWITZ'S PROPOSALS FOR COMMITTEE
FRAMEWORK. HE EMPHASIZED THAT PRESIDENT NIXON HAD AFFIRMED
THAT UNITED STATES WILL ASSIST ISRAEL WITHIN FRAMEWORK
OF US AUTHORIZATION AND APPROPRIATION
REQUIREMENTS. HE THOUGHT THAT WORK OF VARIOUS PROFESSIONAL
COMMITTEES COULD BEGIN ALMOST AT ONCE, AND BE FOLLOWED UP
BY MEETING OF JOINT CABINET COMMITTEE IN LATE FALL.

12. AT INVITATION OF SECRETARY SIMON, UNDER SECRETARY
BENNETT COMMENTED ON GENERAL FRAMEWORK OF US-ISRAEL
AID. HE OBSERVED THAT APPROPRIATIONS
WILL CONTINUE TO BE REQUIRED ON AN ANNUAL BASIS,
THOUGH HE WOULD NOT RULE OUT OBTAINING AUTHORIZATION LEGIS-
LATION FOR MULTIYEAR PERIOD. WITH REGARD TO PROBLEM OF
HIGH INTEREST RATES ON MILITARY CREDITS, BENNETT EXPRESSED
VIEW THAT THESE WOULD DECLINE AS OTHER US INTEREST
RATES DECLINE, ASSUMING OUR ECONOMIC POLICIES ARE SUCCESS-
FUL. IN ADDITION HE HOPED THAT INSTITUTION OF FEDERAL
FINANCING BANK BEFORE NEXT YEAR WOULD ELIMINATE SUCH
PROBLEMS AS ISRAEL EXPERIENCED IN 1974 IN CONNECTION
WITH MILITARY CREDIT. HE ALSO SUGGESTED, AND
SECRETARY SIMON ENDORSED, THAT BUSINESS COUNCIL BE SET
UP TO WORK IN PARALLEL WITH GOVERNMENTAL BODIES; THIS COULD
GREATLY FACILITATE PUBLICIZING AND ENCOURAGING INVESTMENTS.

13. MR BRADFIELD, ASSISTANT GENERAL COUNSEL OF
TREASURY, GAVE DISCOURAGING REPORT ON PROSPECTS FOR
CONGRESSIONAL RATIFICATION OF TAX TREATY WITH INVESTMENT
INCENTIVES IN IT. HE NOTED TWO TRIES FOR TREATY WITH
SUCH PROVISIONS HAD FAILED. HE RECOMMENDED THAT WE
NEGOTIATE TREATY ON AVOIDANCE OF DOUBLE TAXATION WHICH
EXCLUDED CONTROVERSIAL PROVISIONS. HE THOUGHT THAT
ADVANTAGES OF SUCH A TREATY FOR ENCOURAGING INVESTMENT
WERE GREAT ENOUGH WITHOUT INVESTMENT INCENTIVES TO
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WARRANT PROCEEDING. NEUDORFER COMMENTED THAT LACK OF TREATY ACTUALLY DISCRIMINATES AGAINST AMERICAN INVESTOR VIS-A-VIS OTHER COUNTRIES. HE URGED, HOWEVER, THAT WE MAKE FURTHER EFFORT ON TREATY INCLUDING INVESTMENT INCENTIVES, NOTING ISRAEL HAD SUCCESSFULLY NEGOTIATED SUCH TREATIES WITH OTHER COUNTRIES. BRADFIELD SAID HE COULD NOT BE SANGUINE ABOUT PROSPECTS IN PRESENT CLIMATE; AND HE WAS SUPPORTED BY SECRETARY SIMON, WHO WAS EVEN MORE NEGATIVE, ON BASIS OF HIS RECENT APPEARANCES BEFORE CONGRESSIONAL COMMITTEES.

14. MESSRS BILLER (STATE) AND HOSTELER (COMMERCE) THEN COMMENTED ON PROSPECTS FOR ENCOURAGING INVESTMENT. MR BILLER SAID THEY HAD FOUND THAT KEY TO INVESTMENT IS CONFIDENCE BY INVESTOR THAT

- (A) INVESTMENT WAS FREE OF THREAT OF NATIONALIZATION OR EXPROPRIATION AND THAT PROFITS COULD BE REPATRIATED;
- (B) INVESTOR WOULD HAVE FLEXIBILITY TO MAKE DECISIONS IN ESSENTIALLY FREE-MARKET ENVIRONMENT;
- (C) GENERAL ECONOMIC POLICIES OF COUNTRY WERE SOUND.

HOSTELER WENT ON TO DETAIL RANGE OF SERVICES COMMERCE DEPARTMENT COULD PROVIDE TO INVESTORS. IN REPLY MOSHE GOREN (DIRECTOR OF INVESTMENT CENTER) EMPHASIZED THAT MOST IMPORTANT STEP WOULD BE PROVISION OF REAL FINANCIAL INCENTIVES, SUCH AS TAX BREAKS, POLITICAL INSURANCE TO OVERCOME ARAB BOYCOTT, AND R&D TRANSFERS.

15. MOSHE MANDELBAUM (DIRECTOR GENERAL OF MINISTRY OF COMMERCE AND INDUSTRY) PRESENTED CASE FOR ASSURING SUPPLY OF ESSENTIAL RAW MATERIALS AND OIL TO ISRAEL. HE ASKED FOR GUARANTEE OF FREE FLOW OF RAW MATERIALS FROM UNITED STATES TO ISRAEL, GUARANTEE THAT ISRAEL COULD PURCHASE RAW MATERIALS FROM US STRATEGIC STOCKPILES, AND ASSISTANCE IN STOCKPILING RAW MATERIALS IN ISRAEL. HE SAID THAT ISRAEL NEEDED TO STOCKPILE APPROXIMATELY \$1.2 BILLION IN VARIOUS RAW MATERIALS, INCLUDING \$200 MILLION NEEDED TO FINANCE STORAGE FACILITIES. IT WAS UNCLEAR HOW MUCH FINANCING FOR OVERALL TOTAL ISRAEL WOULD SEEK. CONFIDENTIAL

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GOI REPRESENTATIVES ALSO URGED IMPLEMENTATION OF US-ISRAEL DESALTING PROGRAM AND DOUBLING SIZE OF US-ISRAEL BINATIONAL SCIENCE FOUNDATION. KEATING

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